Herfy Foods
4Q2018 Results Review
3 March 2019

السعودي الفرنسي كابيتال
Saudi Fransi Capital

Restaurant Metrics Continue to Improve

Herfy announced inline and encouraging 4Q18 results with +9% Y/Y revenue and earnings growth, EPS of SAR 0.81 met our SAR 0.80 forecast. Store metrics are stabilizing as net additions have decelerated from 2015 levels, reflecting longer maturing cycle. However, we believe growth can be sustained by expanding beyond GCC. Key risk in KSA will be low double-digit wage inflation through 2020 pressuring margins lower in the absence of productivity gains. Reiterate Buy and SAR 58 target price, representing 12.3x 2020E EV/EBITDA.

Sales per store stabilizing

Revenues during the quarter gained +9% Y/Y to SAR 325 mln, ahead of our SAR 318 mln forecast, and +6% Y/Y for F2018 to SAR 1,227 mln. Meat sales jumped +24% in 2018 while restaurant and bakery segments were up +6% and +5%, respectively. Notably, restaurant showed stabilizing sales per store at SAR 2.84 mln (-0.4% Y/Y) on 21 net store additions, up from 12 in the prior year. Store additions have substantially decelerated from 43 in 2015, reflecting longer maturing cycle. Further, Herfy has focused on closing underperforming stores in the recent quarters to improve store metrics. Total restaurants reached 369 (40 owned, 329 leased).

Employee costs squeeze margins

Gross margin contracted nearly 200 bps from 4Q17 to 28%, while EBITDA margin was stable at 24%. Two trends worth highlighting were employee costs and rents. Total employee costs increased +11% in 2018 versus +0.3% in 2017 driven by higher proportion of Saudis and foreign worker fees. Second, rents were negotiated down indicating benign environment. Rental locations increased by 18 in 2017 and 22 in 2018, however the growth in rental expense was significantly lower at +4% in 2018 vs +16% in 2017.

Earnings inline – wage pressure could acclerate

4Q net income of SAR 52 mln (+9% Y/Y) met forecast. For F2019, we project earnings growth of +5% Y/Y on continued improvement in store metrics. Possible drivers of growth could be healthier options on the menu, reflecting changing consumer preferences and market share gains from competitors (e.g. Burger King, McDonalds). Key risk in our view will be sustained wage inflationary pressure as fees on foreign workers will rise to SAR 500-600 / month this year, comprising nearly 20% of monthly pay. Second, the minimum ratio of Saudi workers in restaurants may be scrutinized to incentivize job creation, potentially following the lead from broader retail trend. We assume low double-digit wage growth in 2019, low pricing power and higher worker productivity.

Looking beyond GCC for growth

In the context of substantially altered domestic operating environment, we believe Herfy could tap neighboring countries for growth. Recent expansion into Bangaladesh could be followed by Pakistan which has upwardly mobile, young population with growing appetite for fast food.

Herfy (SAR mln)	4Q18	4Q18E	4Q17	*Y/Y Chg*	3Q18	*Q/Q Chg*	*Variance*	Consensus
Revenues	325	318	299	*9%*	329	*-1%*	*2%*	318
Gross profit	91	92	89	*1%*	97	*-6%*	*-2%*	
Gross margin	*27.9%*	*29.0%*	*29.9%*		*29.4%*			
Operating profit	57	56	52	*8%*	62	*-9%*	*1%*	
Operating margin	*17%*	*18%*	*18%*		*19%*			
Net income	52	52	48	*9%*	58	*-10%*	*1%*	52
Net margin	*16%*	*16%*	*16%*		*18%*			*16%*
EPS (SAR)	0.81	0.80	0.74	*9%*	0.90	*-10%*	*1%*	0.81

SAR 58 — 12-Month Target price

Buy — Recommendation

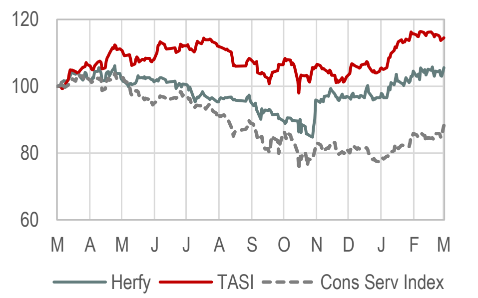
Stock Details		
Last Close Price	SAR	49.20
Upside to target	%	17.9
Market Capitalization	SAR mln	3,182
Shares Outstanding	mln	65
52-Week High	SAR	49.70
52-Week Low	SAR	38.00
Price Change (YTD)	%	7.9
3-Mth ADTV	thd	52
EBITDA 2019E	SAR mln	311
Reuters / Bloomberg	6002.SE	HERFY AB

SAR mln	2018	2019E	2020E
Revenues	1,227	1,285	1,337
Gross Margin	*28%*	*28%*	*28%*
EBIT	221	229	237
Operating Margin	*18%*	*18%*	*18%*
Net Income	204	214	222
Net Margin	*17%*	*17%*	*17%*
EPS (SAR)	3.16	3.31	3.43
DPS (SAR)	1.00	2.25	2.50

Price Multiples

	2018	2019E	2020E
P / E	15.6x	14.9x	14.4x
EV / EBITDA	11.4x	11.0x	10.6x
P / S	2.6x	2.5x	2.4x
P / B	3.4x	3.5x	3.2x

1-Year Share Performance (Rebased)



Source: Bloomberg, Tadawul, SFC

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Rating Framework

BUY

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

HOLD

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

SELL

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

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